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Beyond Technical Analysis

How To Develop and Implement a Winning Trading System

SECOND EDITION

Tushar S. Chande, PhD

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To my awesome co-inventors
Vidya, Ravi, and Aroon

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Preface

The new edition reflects my intense experiences as a Commodity Trading Advisor (CTA), developing systems, trading over 60 futures markets around the world and marketing services to clients. The additions to the second edition spring from my research to find effective answers to clients' questions about trading systems, risk control procedures, and expectations of future performance. For example, try giving a simple answer to the question, "What's a 'good' benchmark for performance comparisons of CTAs, hedge funds, and stocks?" I developed tools for comparing managers, analyzing equity curves, quantifying risk-adjusted performance, estimating drawdown risk, and projecting expected returns. These tools have been tested and accepted by many large allocators in the managed futures business and can be applied to stock indexes and mutual funds. Hence, they should be useful to many investors and allocators.

As part of the 24/7/365 experiences of a CTA, I faced my share of difficult markets and learned unforgettable lessons about the applications of sports psychology to the trading environment. Research by psychologists into the state of "flow" is also useful to build a framework for analyzing trader's reactions to the stresses of trading. This additional material in the second edition summarizes insights gained the expensive way. You can use it to cope with the inevitable stresses of trading.

In presentations to clients, there is rarely enough time to explain the nuances of design tradeoffs. Hence, marketing necessities led to the development of simplified schemes for classifying entry and exit strategies and system designs to explain the strengths of trading strategies. These classification schemes may be useful to you in your own iterations.

The new edition allowed me to give a true out-of-sample performance update for systems discussed in the first edition, and to show how to trade futures as well as stocks with the same system. This edition also includes an illustration of how CTAs derive their returns, and how to develop stabilized money-

manager rankings. A review section of the basics of technical analysis is included at the request of many readers.

Since the publication of the first edition, I have had the good fortune to meet some of the most successful traders in the futures business, with individual net worths of $50 million to $100 million, and even beyond. They had reached the top of the mountain, and I tried to understand what got them there. I have summarized these impressions graphically in the form of the trader's mountain in the first section of the new edition. I am happy to report that the top traders agreed with the ideas in the first edition, and used many of them in one form or another. The discussions with top traders and the experiences of trading millions of dollars have convinced me that this book is useful in the "real world." I hope most readers will agree that the expanded scope of the new edition fulfills the original purpose of providing practical guidance for developing and implementing winning trading systems.